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INVESTMENT REPORT
FOURTH QUARTER 2019

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Global Equity Outlook–
at the brink of the 2020’s

By Managing Director and Portfolio Manager, Bo Knudsen
C WorldWide Asset Management Fondsmæglerselskab A/S.

My love and passion for listed stocks is as strong as ever.

Not just now because listed equities are relatively cheap compared to the alternatives. Even after more than a decade of rising stock markets, you still get a solid coupon on select unique stocks, such as the current 2.5% – with a steadily growing dividend yield in Swiss francs – as an owner of the “mother of all stocks” Nestlé. This compares to a ‘safe’ loss of 1% on a Swiss 10-year bond.

And not just because you can benefit from carefully chosen companies growing bigger over time and follow their progress in detail.

But, also because you can influence companies through active ownership by voting and engaging. What a fantastic and timeless vehicle for investing.

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Will the love persist in a downturn?

It is easier to declare your endless love for stocks in good times compared to bad times. And times have been good for many years. Now, like at most year-ends, it is typical for so-called experts to share their optimistic expectations about stock markets for the future. Actually, the experts are generally right as stock markets go up during most years and continue to compound with equities being a potent symbol of the triumph of the optimists. In modern times, equities primarily only run into real trouble when faced with a US recession. The recession risk is being discussed constantly, but modern history shows it only happens about once a decade which, in turn, provokes a massive response from central banks and governments to prevent it from lasting for too long.
We live in the most politically controlled environment in decades as debt burdened central authorities around the world control the most important price of all – interest rates. In times of future trouble, we will get the next wave of unconventional monetary and fiscal policy initiatives. That can and will continue until the disappearance of trust in central authorities and the disappearance of trust in money as we know it. Many doomsday pessimists have made it a business to predict such an outcome, but I would not advise you to hold your breath while waiting for that scenario to unfold.

"Looking into 2020, the most likely scenario is a continuation of the already extended economic cycle but with a pick-up in the industrial part of the economy.

Looking into 2020, the most likely scenario is a continuation of the already extended economic cycle but with a pick-up in the industrial part of the economy. For the first time in a decade, we see coordinated expansive monetary and fiscal policies across the world as politicians worry about a setback after the third mini-recession of the decade as shown in figure 1.

At this stage we have had a negative recessionary signal from one of the most powerful indicators of all time – an inversion of the US yield curve. Hence, we find it prudent to highlight three risk scenarios that shorter-term investors should be aware of.

Figure 1:
Global Composite PMI

Source: Bloomberg as of Dec. 2019

Policy choices are playing a key role and the extreme central bank policy decisions are keeping the macro and stock market cycle going. Some label this as a 'policy bubble peak'.

1) The policy bubble peak
   A surprise reversal of the loose central bank policy would create trouble for markets. This scenario has a low risk of happening in the short term as debt levels to GDP are very high, making governments a big loser if the cost of debt were to rise. The other side of debt is big asset markets as a share of the global economy - the financial economy. The world has become addicted to high asset prices. It is hard to see a reversal, unless it is linked to a long-term increase in inflation expectations and in long-term economic growth prospects.

2) The US election surprise
   A change in the US presidency to Elizabeth Warren or Bernie Sanders would create fundamental underlying business uncertainty and a possible downturn in markets.

3) The Silicon Curtain risk
   Despite a friendly world gathering around the Summer Olympics in Japan in 2020, the rise of nationalism is set to continue. Indeed, this theme is gaining momentum. Politicians are elected on a national level and increased government spending will be domestically focused in a world that is skeptical about the effects of globalization after the financial crisis. Confrontation not just between the US and China about global technological leadership, but also an overall escalation of trade conflicts and breakdown in international organs like the WTO is a potential problem for markets. Not just because it directly reduces trade, but also as it increases uncertainty and pessimism.

Even then to be clear, if a downturn were to happen, my fundamental passion for equities – especially the few truly unique stocks - would persist. Especially if we are going Japanese!

Going Japanese

Japan is one step ahead in living in an aging society. The country is an interesting laboratory for investors to investigate as it gives a peek into what the future might look like for many other important developed economies. Japanese prime minister Abe just launched another record fiscal stimulus package to support the economy. Japan has reached the next stage of monetary policy by having an explicit target on the 10-year bond yield of 0%. Even if it seems that the BOJ has paused its buying of late, the Japanese central bank has a policy of buying equities directly in the market at a rate that it is said to be at USD 55 billion a year since 2016, and it has been a significant buyer every time the market falls more than 0.5%. It is very hard to drive growth in an aging society despite the undisputed qualities and extreme work ethic in the Japanese economy.
I think we need to go full circle in the western world, and this means going through this Japanese exercise – and even further beyond – before we get a paradigm shift in policy thinking. Direct funding of public investment projects and interest rate targeting by central banks, as well as stock purchasing is coming to a country near you – and could become the norm in larger parts of the world.

Based on the Japanese experience, slow economic growth is the likely scenario – see figure 2. Japan has had periods of economic growth around zero and close to full employment. A recession – stagnation – is not such a big thing in Japan. Maybe that is a new normal for most of the world?

Something has changed in the world of economic cycles. There is less volatility in an economic world that has moved from goods to services. Inflation expectations have been anchored at low levels, and we now live in what can be labelled the "financial world economy." It is the tail wagging the dog – the swings in the financial world (interest rates) that drive changes in the real economy and especially with monetary policy driving the financial world, the circle is complete.

Figure 2:
Economic Development (GDP) in Japan

Source: Bloomberg as of Dec. 2019

If the next decade is a slow growth decade, where we hover around 1-2% GDP growth in developed economies such as Japan, we will stay in a long-term low interest environment. A series of soft upturns and downturns – boring, but good. Such a scenario will benefit a select portfolio of sustainable growth stocks – like we have seen in Japan.

Listed equities – still compounding potential – and a melt-up?

> **Inflation expectations have been anchored at low levels, and we now live in what can be labelled the "financial world economy".**

In many developed countries you are now PAYING for the 'privilege' of having money in your bank account.

A large portion of investors who lend out money to governments via buying government bonds also have to pay for that privilege.

The classic balanced portfolio with a core of compounding low risk bonds is compounding no more. But right now, it is as if the stock market can't believe that compounding in big parts of a closely related asset class is dead.

The stock market cannot believe that for the first time in thousands of years, the principle of giving-up something valuable for a longer period doesn't give you a reward. For example, if I was a farmer five thousand years ago, and I was lending-out seeds of corn to my neighbour, I would get more seeds or seed equivalents back next year. That fundamental principle has now been broken with central banks going below zero, dragging world interest rates down and a broad range of assets up. The bond and interest rate markets are at such extremes and the equity markets haven't really discounted it yet. Going back to the previous example, Nestlé is generating a dividend yield of 2.5% and a free CF yield of 4% with an expected growth rate of 4%. At unchanged valuations, Nestlé is an asset that should generate an annual return of 8%. Compare that to the Swiss 10-year bond yield of -1%, and this provides an equity risk premium of 9%.

Even if Nestlé doubled in stock price and then became a 2% free CF yield stock, the FCF yield plus the growth rate of 4% would still compare very well with the -1% of the Swiss bond, resulting in a risk premium of 7%! This illustrates the potential and the significant bull market that could be ahead of us, if markets actually really started discounting and believing in low rates forever. A true melt-up!

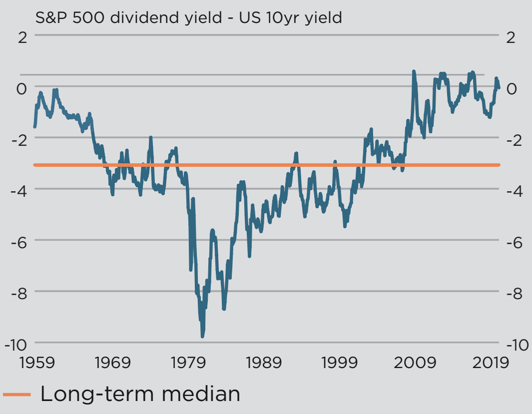
It is quite often the case that the more naturally skeptical bond markets get it first, and then the ever optimistic equity markets follow and come to the same realization. The bond markets are giving you a clear signal – no inflation and low interest rates for years to come. And as highlighted above, bond markets might be right.

But as seen in this graph, public equity markets are not pricing this in yet. In the US, where interest rates are still above zero, the dividend yield is now solidly above the 10-year bond yield – pointing to a relatively cheap stock market as depicted in figure 3.

Where is the bubble?

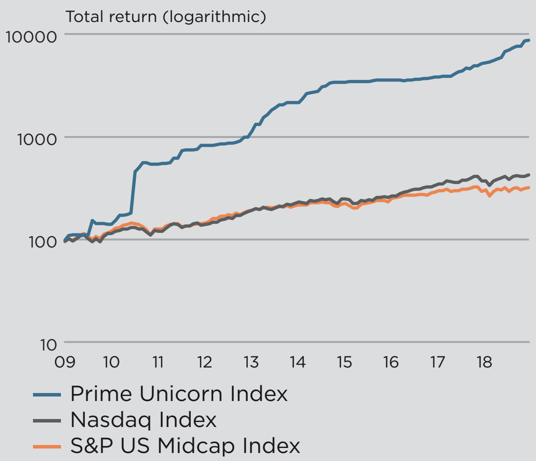
Flow of funds have gone less in the direction of listed equities and more in the direction of alternatives. The unlisted equity space reflects the big flows that have gone into private equity. The valuations of the unicorns in figure 4 have not been subject to public market analysis and valuation. Nevertheless, it is still fascinating to see how the Unicorn index has performed over the last decade in comparison with public market indices.

Figure 3:
Yield difference



Source: Bloomberg as of Dec. 2019

Figure 4:
Divergence between private and public equities



Source: Bloomberg as of Oct. 2019

This could be an area of greater investment risk. The bet is that when the real unicorn stands out, it will generate so much return that you can afford to have the losers as well. The question is if you are in the right fund with the great company pickers or in an average fund that will have a hard time fulfilling these grand expectations.

Five moments in equity market history

As a mindful and long-term oriented investor, selecting the right assets and the right individual stocks is as relevant as ever.

> **"The potential and the significant bull market that could be ahead of us, if markets actually really started discounting and believing in low rates forever. A true melt-up!**

Without going into a discussion about Kuhn's concept of paradigm shifts – essentially shifts of revolutionary nature in common thinking about a certain issue – the power of paradigm shifts reveal themselves when looking back at dominating beliefs in financial markets at the beginning of a new decade over the last 40 year period. So, let us take a quick tour in financial market history to see if we can learn something from this and also something about investing overall that maybe useful for the coming decade.

The focus here is on the big shifts in conventional thinking that happen – with the human imagination seemingly knowing no limits. Such thinking often builds over a long period of time – from a crazy idea to what is ultimately perceived as reality or conventional wisdom, like the idea of having negative interest rates for example. At birth, a bumblebee that can't fly is a fact of life.

A frog being boiled because it doesn't realise that the water is warming, because it is happening slowly. And then the unrealistic becomes reality.

Figure 5:

The decade's top 7 stocks by market cap

1980	1990	2000	2010	2019 - December
IBM	NTT	Microsoft	Exxon Mobil	Saudi Arabian Oil Co.
AT&T	Bank of Tokyo-Mitsubishi*	General Electric	PetroChina	Apple Inc.
Exxon	Industrial Bank of Japan	NTT DoCoMo	Apple Inc.	Microsoft
Standard Oil	Sumitomo Mitsui Banking	Cisco Systems	BHP Billiton	Google
Schlumberger	Toyota Motor	Wal-Mart	Microsoft	Amazon
Royal Dutch	Fuji Bank	Intel	ICBC	Facebook
Mobil	Dai-Ichi Kangyo Bank	NTT	Petrobras	Alibaba

*Merged entities

Source: Gavekal as of December 2019

1980's

Back in 1980, when US interest rates were 10%+ and going higher, we lived in an inflationary environment where inflation was deeply ingrained in the thinking of people and financial markets. 6 of the 10 biggest companies in the world at the time were oil companies with Exxon, Standard Oil and Royal Dutch being on the list, and the list was dominated by US companies. Commodity cycles are cyclical in nature and high prices lead to a supply response. This was another commodity stock peak that did not prove to be long-lasting.

1990's

A decade later, at the outset of the 1990's, only Exxon was left on the list of the 10 biggest companies by market cap in the world. 8 out of the 10 largest were Japanese and 6 of them were Japanese banks such as Fuji Bank and Industrial Bank of Japan. I can personally attest that the common thinking at the time, when I started my career in 1989, was that Japan Inc. would take over the world. It also became clear to many that the massive real estate and debt bubble in Japan was unsustainable. The paradigm shift faded and there was not a single Japanese bank on the list by 2000.

2000's

As many will remember, 2000 was the peak of the internet and telecommunications bubble with US tech companies like Intel and Microsoft dominating the list. Even though that bubble burst, many of the biggest companies of today like Amazon and Google were established in this period. It was more fun to buy Amazon at the bottom in September 2001 at USD 6 per share compared to December 1999 at around USD 100 per share. Still, at the time you would have made good returns buying Amazon at that peak with Amazon now trading around USD 1780 per share, compounding at more than 15% per year since then. The common wisdom at the time was correct. The internet is one of the biggest human inventions of all time with profound consequences for the world including the world of business. You connect the entire world by a web so that ideas from everywhere can meet and prosper. It was a recipe for growth and it provided an arena that created giants as well as many losers. As a platform economy in the making, it took skill to identify the winning companies, particularly as huge disappointment with most stocks in that era followed, which emphasizes the importance of carefully analyzing the individual shares.

2010's

Just after the Great Financial Crisis where the epicenter was the bubble of the US housing market, we find oil and commodity stocks back on top of the list with Exxon being number one in terms of market cap. For the first time in modern history, there were three Chinese stocks with the Chinese banking giant ICBC making the list. After a massive debt increase and very strong growth, China became the world's growth leader post the financial crisis. China's thirst for commodities in the infrastructure and housing boom drove demand of commodity assets and Chinese assets in general. The boom in the demand created again a sharp expansion in the production of raw materials, however the boom in China wasn't sustainable for commodity companies and the Chinese banks. Ten years later, a significant rotation had occurred among the largest companies in the world.

2020's

Now at the start of the 2020's, the US again takes up 8 of the 10 positions on the list of the world's biggest companies – and Microsoft are together with Apple and Amazon in the top 5. We are in the platform economy and software and service apps dominate the top ten list. The two Chinese internet giants Tencent and Alibaba complete the picture of a world economy dominated by the US and China. The fact that China is the most populous country in the world, coupled with all the changes happening there, increases the chance that common perception is right, and that China and the US will dominate the world economy in the 2020's. We continue to believe that the massive transition, where companies shift IT infrastructure to the cloud makes Microsoft and Amazon likely contenders for the top ten list of 2030; and that Microsoft actually makes the top ten list for the fourth decade in a row.

2030's

It's common to assume, that the dominant companies of today also will be the dominant ones in the future. The shift to the cloud benefitting software companies and giant platform companies that are able to manage local and global political tensions well will probably take-up the space on the 2030 top ten list. Both US and Chinese companies are likely candidates. The real surprise could be a European platform company. But history also shows that we can expect major paradigm shifts to come.

One of the biggest waves that we have seen in financial markets is the shift towards more sustainable investing and a sustainable lifestyle. The worry about the climate has been a part of life since the dawn of time. The issue has accelerated and in a connected world, the 'saving the planet' wave is gathering strength across the world. The driver is fear – a very powerful force. Looking out into 2030, we would not be surprised to see next generation alternative energy companies – and probably one of the stocks in the unicorn index being part of the list. Two of the keys is a transition to alternative energy/better energy storage and planting more trees! The energy transformation will happen fast, and markets will be even quicker to discount the potential. As an interesting fact, NASA has published that, based on satellite pictures covering the world, the world has never been greener. Compared to 20 years ago, the planet's green leaf area has increased by 5%. That is an increase of 2 million square miles – equal to the size of the Amazon rainforest. China and India account for a third of the greening, but they make up only 9% of the land area. We would not be surprised to see an Indian company on the list in 2030. This land of eternal promises is probably in the process of finally realizing that enormous potential. Political change and the power of the population in a world where ideas are being shared more efficiently than ever before is the opportunity for India.

> **The valuations of the unicorns have not been subject to public market analysis and valuation. Nevertheless, it is still fascinating to see how the Unicorn index has performed over the last decade in comparison with public market indices.**

Welcome to an extreme reality, where compounding is dead in big parts of the investment universe. But it is still alive and well in the wonderful public stock markets – in good and bad times.

With the right mindset, philosophy and experience, we think the 2020's will be a great decade for the long-term stock picker. The little extra return that a good picker of sustainable growth can find, will play a relatively much bigger part of the returns in the next 10 years compared to the last decade.

By taking a generational perspective on the stock selection, we ensure that returns and sustainability goes hand in hand. For over three decades we have travelled around the world and have found unique companies with sustainable business models and strong managements. It is this work that is our passion.

> **The little extra return that a good picker of sustainable growth can find, will play a relatively much bigger part of the returns in the next 10 years compared to the last decade.**

C WorldWide Stock Picking
Using Global Trends and Themes

By Morten Springborg,
Global Thematic Specialist, C WorldWide Asset Management.

Key takeaways

- We are first of all stock pickers at C WorldWide. The stock specific dimension is the dominant factor, but it is our view that C WorldWide's Trends and Themes support good Stock picking.
- For us this is not a new fad or discipline as we have been Trend based, thematic stock pickers since our inception in 1990.
- We are often asked how we use Trends and Themes in our work. This White Paper has the purpose of explaining just that.

Why trends and themes?

Trends and themes are the prisms through which we look at the world in order to understand and anticipate change in society.

Our trend-based, thematic investment approach helps us to differentiate between the day-to-day noise in markets and what is truly lasting knowledge that one can accumulate and hopefully provide superior investment insights over time. Stock markets are often myopic and short-term in nature reflecting biases in human behavior. This has become both more evident and pronounced over time. We believe that taking a long-term view is the best way to achieving alpha for active investment managers.

We think of trends as being behavioral in nature and very long term, typically generational. Trends capture glacier-like shifts in society and are therefore not particularly investable. They are, however, very valuable in organizing thought processes.

Themes are organized around the major trends, and as such, are more operational when it comes to thinking about how to deploy capital. The longevity of a theme can also be decades, but typically they tend to develop and mature over 3-10 years. We have identified more than 50 themes linked to 5 major trends.

Trend-based, thematic investing is a framework that stimulates forward-looking long-term thinking. It focuses our resources on the most promising areas of investment and, as a result, leads us away from benchmark thinking – with the benchmark reflecting the past and not the future. It is an approach that ensures a more efficient use of the scarce resource of time.

Stock valuation in a thematic framework

The classic way of looking at the value of a stock can be useful when considering how trends and themes directly influence stock prices. The value of a stock being the risk adjusted NPV of future dividends/ free cash flows highlights the importance of the key components of time, growth and risk.

Time – longevity

The importance of time is underestimated in financial markets. The power of compounding is essential and linked to longevity of structural change. Obviously the NPV calculation benefits from longevity – the longer you have thematic tailwinds the better – hence thematic tailwinds can justify higher short-term valuation multiples.

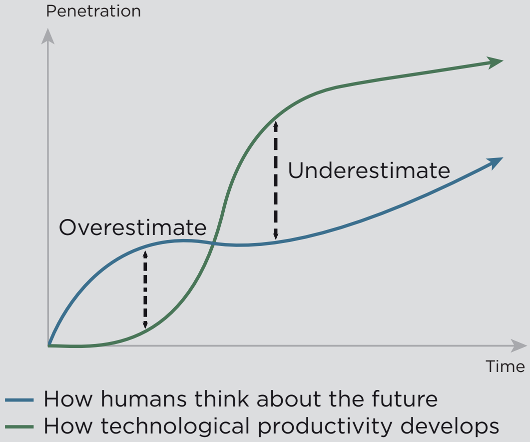
In the 1970's Stanford University computer scientist and longtime Head of the Institute for the Future Roy Amara observed that "We tend to overestimate the effect of a technology in the short run and underestimate the effect in the long run". This observation later become known as Amara's law. We think this observation is an excellent way to frame thematic thinking as well as a way to explore behavioral biases

> **Our trend-based, thematic investment approach helps us to differentiate between the day-to-day noise in markets and what is truly lasting knowledge.**

in equity markets. It also neatly explains why the idea of "mean reversion" in equity markets is so often a myth, and something that the longterm focused investor can take advantage of.

Figure 1:

Amara's Law



Source: C WorldWide as of Dec. 2019

When a new theme emerges markets often become overexcited about the imminent possibilities that it gives. Then, time goes by and nothing much happens. Soon the cynics are starting to say the whole thing was hype. This turns out to be just the inflexion point when the theme turns ubiquitous and disruptive.

We have a growth bias but focus on the sustainability over magnitude of growth. Typically, we view the early hype phase as being too early for us to deploy capital, while we tend to get more involved once we have gone past the initial hype and gotten confirmation it's not a fad and market leaders are evolving. It is this phase of the theme development we deem most lucrative as there will be a tendency in markets to discount too early the maturation of growth – or the eventual reversion to the mean, which so often tends to be premature.

At this point in the cycle you typically will pay a high price for the company, but if the company has strong thematic support you are rewarded by the compounding of earnings for much longer than the market is pricing. We spend most of our time working out "what to own". Valuation is a critical input in our decision-making process, but it is rarely if ever our starting point. Our margin of safety has more to do with our confidence that a company's competitive advantages will stay strong and or get stronger, than some estimate of a discount to intrinsic value. In our opinion, it is easier to be correct on the strength and longevity of the business model than the estimate of intrinsic value.

If a theme is coming to the end of its life you run the risk of not just losing the thematic earnings (cash flow) support but also the thematic valuation support as perceptions change. It is our experience that perceptions change slowly and need dramatic events like profit warnings to eventually influence the stock price. You have time to react.

It can be difficult to figure out how long a theme is going to last. Therefore, it is important to understand if a theme is weakening or strengthening – essentially answering the question: are thematic developments moving in the right or the wrong direction in the shorter term – as one of several ways of understanding stocks and longevity.

> **The importance of time is underestimated in financial markets. The power of compounding is essential and linked to longevity of structural change.**

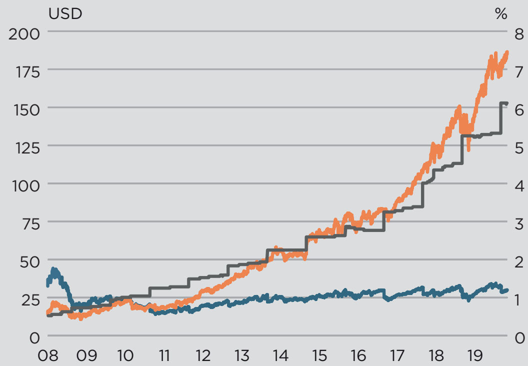
We believe that investment risk can be minimized by looking for companies with strong moats and high returns that can be reinvested at the same or a higher rate of return. An example of this could be VISA, that has the support from several themes like Cash2Card, Financial Inclusion, e-commerce and Emerging Markets Middle Class growth. Visas share price has done well rising along with its underlying earnings power which has been supported by favourable thematic exposures as the chart below shows.

Growth

The growth rate is another key in compounding – building a bigger company faster. The stronger the theme, the better the opportunity for the company to become bigger – helping the stock price development over the compounding period. Hence, you ideally need to understand how fast and for how long the company can expand. Total addressable market (TAM) considerations are useful in this evaluation. The acceleration phase for a theme can be very powerful but it is also important to understand how long that phase is and what happens after that phase. Our priority is sustainability above magnitude of growth.

Figure 2:

Earnings Growth Drives Share Prices



Visa - Price (Left)
Visa - PE (Left)
Visa - EPS (Right)

Source: Factset as of Dec. 2019

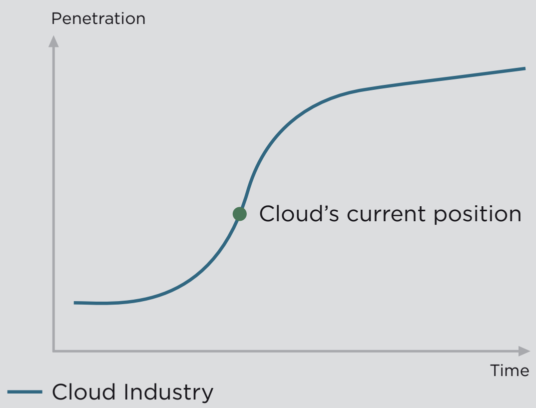
Past performance is not a reliable indicator of future performance

Themes have different S-curves depending on the longevity as well as the growth rate of the theme. Some are longer and some shorter, and some are very steep while others may be shallower. Taking the 'cloud transition' theme as an example, we believe we are potentially investing into one of the strongest themes in living memory since the cloud companies are amongst the fastest growing large companies ever. We also believe the TAM opportunity of the cloud companies is hugely underestimated and therefore the growth phase will be much longer than is currently being priced in by markets.

The discount rate – perceived risk

There are themes we have higher confidence in than others – a dimension you also want to take into consideration. We would argue that you should use a higher implicit discount rate for early stage technologies such as 'augmented reality' since both market leaders as well as the business models are unknown. By contrast, we believe the theme of 'cloud transition' is so well established and we know the dominant players of the future, so we can discount future cash flows at a lower discount rate compared to what the market is applying today.

Figure 3:
The Cloud Transition



Source: C WorldWide as of Dec. 2019

Furthermore, some types of companies probably deserve significantly lower discount rates than others in similar phases of their life cycle. These are the "winner-take-all" platform companies who, because they control large and scalable networks of clients/consumers, have very defensible business models which are extremely difficult to disrupt.

In addition, we believe one of the most important trends of our time – namely demographics and the aging population – is having a significant influence on discount rates via the real interest rate, that will stay secularly low for an extended period. This is described in our White

Paper entitled Demographics, Real Interest Rates And Equity Markets (July 2018). This is of utmost importance since demographics for at least the next couple of decades will act as an anchor for discount rates to the benefit of owners of long duration assets like growth stocks.

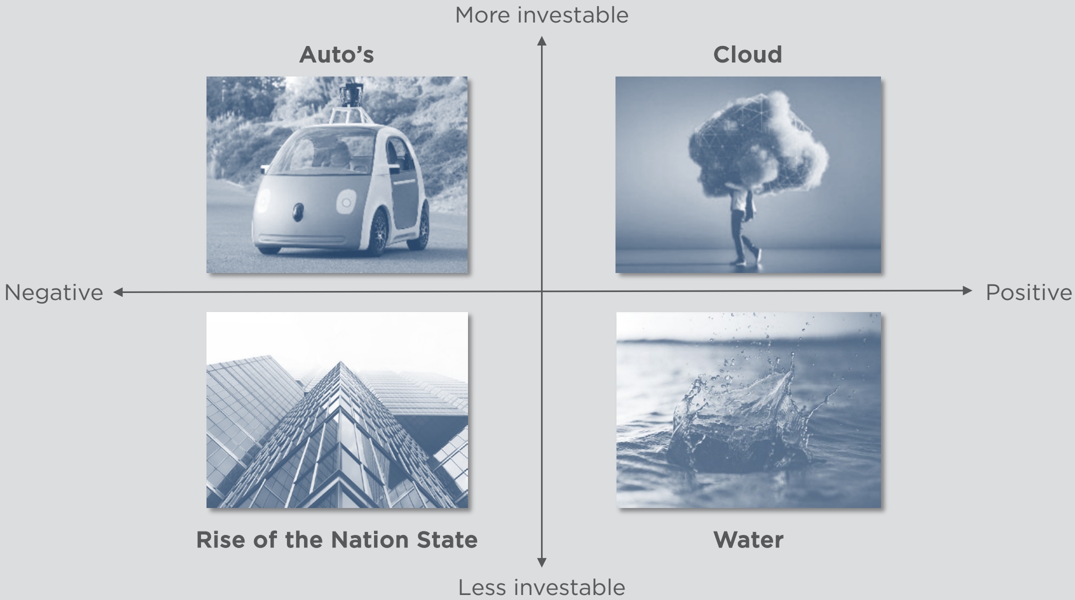
The relevance of themes varies

As a long-only equity manager the themes we focus on tend to be positive drivers of change for exposed companies. However, increasingly themes can also be negative and reasons for exclusion. Furthermore, some themes are very important to understand because they have a broad impact on society but, at the same time, are less investable for us. Therefore, one can also think of themes along the two axes of 1) investability and 2) degree of positive change.

We recently repurchased Microsoft as we have become even more convinced that the transition to the cloud is still in the early phase of enterprises shifting IT budgets to public and hybrid clouds. Cloud computing is an example of a highly positive as well as investable theme. The market has a very high degree of concentration as only a handful of players (primarily Amazon, Microsoft, Google in western markets) dominate the market. We have written about The Age Of The Cloud in an earlier White Paper (Sept 2016) and more recently in Cloud Computing at an Infliction Point (Oct 2019).

As an example of a negative and investable theme one can look at what is happening to the global auto sector. The sector is going through unprecedented change due to the simultaneous shift to electrification, autonomous driving as well as transportation as an (app)service. The investment needs for the incumbents are enormous, while there is almost zero visibility when it comes to the longer-term profitability of the sector, except to say that it will most likely be much lower than we have witnessed historically. Therefore, we view the themes affecting the auto sector as being both investable also but highly negative. Our conviction is that most of the companies exposed to legacy internal combustion engine (ICE) technology are value-traps which we don't need to spend resources on analyzing. We have written about the auto industry in the White Paper The Coming Cambrian Explosion in technology.

Figure 4:



Source: C WorldWide as of Dec. 2019

Water is an example of a potentially highly positive theme because one should expect that the growing scarcity of water would lead to some interesting investment opportunities. However, for us water is also an example of a less investable theme, since water related companies are either highly regulated low return utilities or extremely fragmented tech/equipment manufacturers typically owned by conglomerates where the water exposure gets diluted.

We view the rise of the 'nation state' as an example of both a less investable as well as a negative theme. It is very important to consider the implications of the rise of the nation state, since at its core, it is an attack on globalization and therefore indirectly impacts the economic superstructure that has been built up since around the early 1980's. The ramifications for trade, security and supply chains could potentially be significant. We have recently published two White Papers touching on these issues, namely Made In China 2025 and The New Tech War And The Geopolitics of 5G.

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> **We we will never invest in a high conviction theme through a low conviction stock. At the end of the day, the stock is what generates the return.**

Finally, it's important to highlight that while themes support portfolio construction by identifying interesting pockets of growth, and help us prioritizing our use of time, we will never invest in a high conviction theme through a low conviction stock. At the end of the day, the stock is what generates the return. The holy grail of compounding of earnings is more likely to happen when we can combine a high conviction theme with a high conviction stock pick.

Figure 5:

Interaction Between Themes And Stocks

	High conviction theme	Low conviction theme
High conviction stock	"Where magic happens"	Occasionally
Low conviction stock	Never	Never

Source: C WorldWide as of Dec. 2019

Contribution

It is difficult to accurately separate out the level of alpha generation that has been generated by pure stock picking and the contribution of return from our themes selection. Because at the end of the day our documented alpha generation is not generated by themes but by the stocks we are invested in. However, we remain convinced that our thematic focus steers us in the right direction when selecting stocks. The strongest contribution to our long-term outperformance has been in the themes of Emerging Markets, Connected Lives, US Housing, Energy and Demographics. Certain themes that have worked less well for us have been Energy Efficiency, Financial Recovery and Abenomics/ Japanese restructuring. In general, the most important lesson we have probably learned over the last 30 years of thematic stock picking is that stocks and themes that are dependent on political decisions and/or government regulation in order to play out, carry more risk than investment themes that can develop independently of politics.

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We focus on sustainability over magnitude of growth, and believe a thematic analysis helps us identify companies that can compound earnings over many years.

Integration of thematic thinking and stock picking is essential

For us, theme-based stock picking is not a fad but something we have been doing for the past 30 years and which is ingrained in our stock picking process. We believe our trend-based thematic investment approach is an important part of our alpha generating capability, in that we think it both focuses our attention on the most likely areas of value creation as well as enabling us to explore behavioral biases in markets that have become excessively short-term focused. We focus on sustainability over magnitude of growth, and believe a thematic analysis helps us identify companies that can compound earnings over many years. As the world evolves over the coming years, we will continue to analyze change through the prism of themes and hopefully continue to generate outperformance as we have done for the last 30 plus years – with our unique style of trend-based, thematic stock picking.

C WorldWide
Global Equities ex. Tobacco

Quarterly comment

The fourth quarter added another leg-up to the strong climb of the equity markets this year. We received more clarity on a number of fronts with 1) Global Central Banks pausing, 2) Brexit drama ending and 3) The US and China trade dispute moving towards a partial deal. Despite all these uncertainties through-out the year, the global consumer and the economy look to be in good shape. In the quarter, cyclical companies outperformed defensives. The strategy's gross return was 4.7% in the quarter, while the MSCI AC World Index returned 4.5%. Industrials, such as Atlas Copco and Siemens did very well as did HDFC. Consumer defensive stocks like Unilever and Procter & Gamble were a drag on return. Year-to-date, the strategy had a strong year with a gross return of 32.4% vs the benchmark return of 26.8%, where especially Visa, Ecolab and Thermo Fisher were some of the important contributors to return.

Investment strategy and strategy changes

The strategy remains unchanged with a balanced structure of companies in different parts of the growth spectrum.

We decided to reinvest in our old favorite TSMC. TSMC is still the world's largest dedicated chip foundry with over 50% market share giving them massive scale advantages. TSMC has been preparing for another era of strong growth driven by 5G & IoT. Banks are facing many structural headwinds (low interest rates, regulation and competition from non-banks), which is why we have used the latest rally in Wells Fargo to sell our position. The world will have to go through a major energy transition as the threat of climate change is real and present. ExxonMobil has been less inclined to be part of the solution and therefore we have chosen to change our exposure in energy by replacing ExxonMobil with NextEra Energy. NextEra Energy is the world's largest generator of renewable wind and sun and is the lowest cost producer of electric power in North America. Given how cheap wind power has become in key areas of the US, we see these advantages yielding attractive growth opportunities well into the next decade for NextEra Energy.

Finally, we think the unrest in Hong Kong is going to have longer-term effects on the attractiveness of Hong Kong as a tourist and business destination. We therefore decided to sell our holding in Sun Hung Kai Properties and to reinvest the proceeds in Hoya, ASML and Bank Central Asia.

C WORLDWIDE GLOBAL EQUITIES EX. TOBACCO COMPOSITE

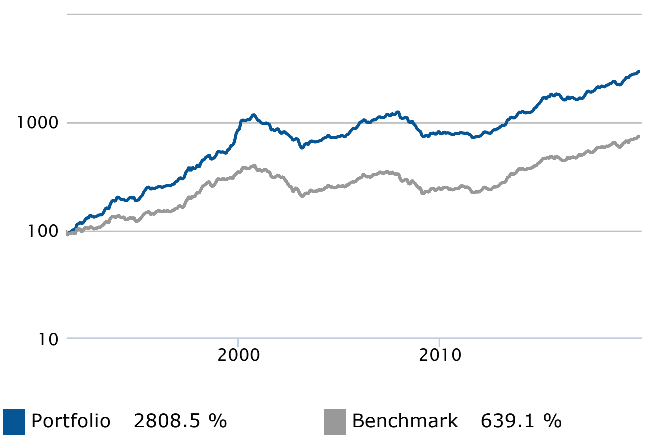
GROSS OF FEES IN AUD AS OF 31 DEC 2019

INVESTMENT PHILOSOPHY

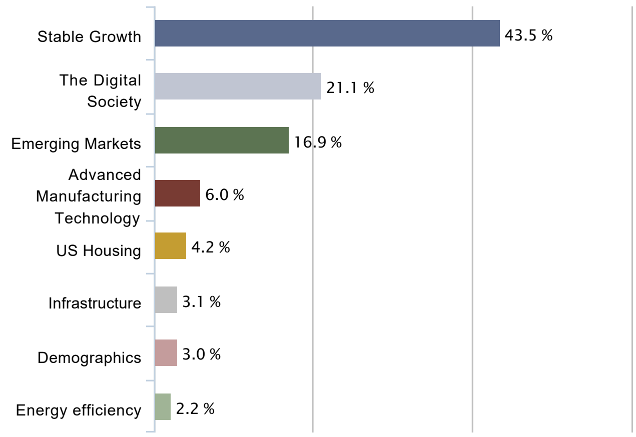
Strategy	**C WorldWide Global Equities Ex Tobacco Composite**
Launch Date	31 May 1991
Benchmark	MSCI All Country World incl. net dividends

The strategy aims to achieve long-term capital growth exceeding the return of the market with a moderate risk profile as measured by standard deviation. The portfolio consists of 25 to 30 high conviction global large cap stock picks that ensure a sufficiently high-risk diversification. There are no geographic or sector restrictions in the strategy.

INVESTMENT RETURNS



THEMATIC EXPOSURE



RETURN & RISK

	Q4	**YTD**	**1 Y**	**3 Y**	**5 Y**	**10 Y**	**Lifetime**
Portfolio (%)	4.7	32.4	32.4	20.2	14.3	13.5	12.5
Benchmark (%)	4.5	26.8	26.8	13.6	11.8	11.5	7.2
Relative performance (%)	0.1	5.6	5.6	6.6	2.6	2.0	5.2

	3 Y	**5 Y**	**10 Y**	**Lifetime**
Std. dev. portfolio (%)	9.6	11.4	10.4	13.8
Std. dev. benchmark (%)	9.3	10.0	9.5	12.0
Beta	0.9	1.0	1.0	1.0

Periods longer than 1 year are shown annualized

TOP 10 HOLDINGS

	Share in %
Visa	7.7%
HDFC	7.4%
AIA Group	4.7%
Alphabet	4.6%
The Home Depot	4.2%
Thermo Fisher Scientific	4.2%
Microsoft	4.1%
Amazon.com	4.0%
Ecolab	3.9%
Keyence	3.8%

CONTRIBUTION

Top 5	**Contribution**	**Return**
HDFC	1.1	16.2
Siemens	0.5	17.1
Atlas Copco	0.5	25.2
Sony	0.4	11.2
Visa	0.4	5.0

Bottom 5	**Contribution**	**Return**
The Home Depot	-0.4	-9.2
Ecolab	-0.3	-6.3
Unilever	-0.2	-7.6
Nestle	-0.2	-4.4
Procter & Gamble	-0.1	-3.1

All figures are based on past performance. Past performance is not a reliable indicator of future performance. The currency is AUD. The return may increase or decrease as a result of currency fluctuations. The figures are based on a GIPS composite and the full GIPS report is available upon request. The figures are gross of investment management fee and performance fee, if any. Other fees, incurred by the investor, such as custodian fee and transaction costs, are not included.

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The currency is AUD. The return may increase or decrease as a result of currency fluctuations.
The gross figures are gross of investment management fee and performance fee, if any.
Other fees, incurred by the investor, such as custodian fee and transaction costs,
are not included in the gross figures. The net figures are based on the actual performance including costs of all portfolios.

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